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Business and Economic Conditions

New York, February, 1957

General Business Conditions

THE business reports in January do not warrant altering the generally sanguine expectations evident in year-end forecasts. Passenger car production and sales are running above year-earlier levels for the first time in over a year, steel mill operations continue close to earlier peaks, and petroleum output has set new records in meeting demand at home and abroad. Brisk wholesale buying is reported from January trade shows. Industrial purchasing agents — like a great many consumers — are basically optimistic, even though inclined toward caution in their purchases.

The strong finish of 1956 left little doubt that sheer momentum would carry business along at peak rates during the first few months of 1957. The upsurge in over-all output of goods and services during the fourth quarter of '56 was unsurpassed in any quarter in the past four years. Even allowing for price increases, which during the year accounted for about half of the over-all rise, the fourth quarter advance was impressive.

CONTENTS

Spurts in consumer durable goods buying, defense spending, and business investment in equipment and inventories were strong influences. According to preliminary estimates by the Council of Economic Advisers, gross national product achieved the record annual rate of $424 billion in the fourth quarter, up from $413.8 billion in the third quarter.

Meanwhile, consumer spending plans were fortified by the rise in incomes to a new peak of $287 billion after taxes. Corporate profits, which had been declining since late 1955, are tentatively estimated to have rebounded in the fourth quarter to an annual rate only slightly lower than a year earlier.

These recent advances have been sizable but far from unanimous. As usual, there are soft spots along with the strong ones. A number of industries, including lumber, paper, and paperboard, are operating below last January's rates, while in other lines the steam appears to have gone out of expansion. Nevertheless, there can be little doubt of the strength of over-all demand. It has been strong enough to offset these soft spots and push industrial production and non-residential construction to new peaks in December, to keep skilled labor in short supply, and to maintain a record flow of goods through retail stores. Above all, the pressure of demand, along with higher wages and raw materials costs, is evident in the steady rise in prices, which has once more focused attention on the problem of inflation.

Prices at a New Peak

Prices in wholesale and retail markets have climbed to record levels. The official index of wholesale prices (1947 – 49 = 100) advanced to 117.0 in late January, breaking the record which had stood for nearly six years. During the past year, prices of farm products and processed foods have risen more than 6 per cent and prices of other commodities — mainly industrial goods — averaged 4 per cent higher. The consumer

price index, at a new record of 118.0 in December, was 2.9 per cent higher than a year earlier.

A price rise of this magnitude, of course, does not represent runaway inflation. The rise in consumer prices during 1956 was not appreciably greater than the average rate of increase for the past ten years. Yet creeping inflation cannot be ignored. It is sobering to reflect that through this process of gradual erosion — averaging less than 3 per cent per year — the dollar has lost nearly one third of its purchasing power in a decade.

In the year-end forecasts of 1957 business, economists reached well-nigh universal agreement on two points: that increasing government expenditures would afford the main expansionary stimulus, and that prices would rise further. These expectations are associated. In an economy running at maximum sustainable speed, with many private employers handicapped by shortages of skilled help, no need is present for increased government expenditures to provide employment opportunities. Many people share the misgivings expressed by Senator Byrd, in commenting on increased outlays programmed in the new federal budget, that "we have embarked upon another era of inflation."

Reappraising Investment Programs

As the President's Economic Report stated, "There are grounds for confidence that the nation's overall prosperity will be extended into the months ahead." Nevertheless, there is not — and never has been—a guarantee that such prosperity will be distributed evenly among business firms. The year ahead is expected to be highly competitive, and, as in 1956, many firms will find their profit margins pinched between rising costs and consumer resistance to price increases. The squeeze on profits — either actual or anticipated — provides incentive for many concerns to review their capital spending plans.

In reappraising their investment policies, some firms are finding that expansion is not necessarily the key to increased profits. Others are finding their cash flow diminished by a squeeze on profits at the same time that monetary policy has made outside funds harder to raise. Few firms, however, appear to be curtailing capital spending programs to any marked degree. Postponement of construction of several multi-million dollar plants made headlines in recent weeks, but these decisions represent more a reallocation of resources within capital programs than a general cutback.

The road to increased profits differs from one company to the next, but seldom does it involve standing pat. For some concerns, increased volume, broader markets, and perhaps new products may lower unit costs and improve profits. Certain firms, experiencing the inefficiencies of sustained capacity operations, may find expansion of facilities the key to cost-cutting. But the search for higher profits may also lead to extracting maximum utilization from existing plants, instead of building new ones. Rearrangement of production lines, installation of laborsaving and cost-cutting equipment, and other methods of promoting efficient operations are receiving increased attention.

Some statistical clues point to a shift during 1957 from the brick - and - mortar type of investment to greater emphasis on modernization. Contracts for future construction of new factory buildings, as compiled by F. W. Dodge Corporation, declined sharply in the latter part of '56; during the fourth quarter, contract awards were 30 per cent below the corresponding period of '55. New orders for machinery, however, were reported by the Department of Commerce to be up 11 per cent year-to-year in October and November — the latest months available.

Steel Catching Up With Demand?

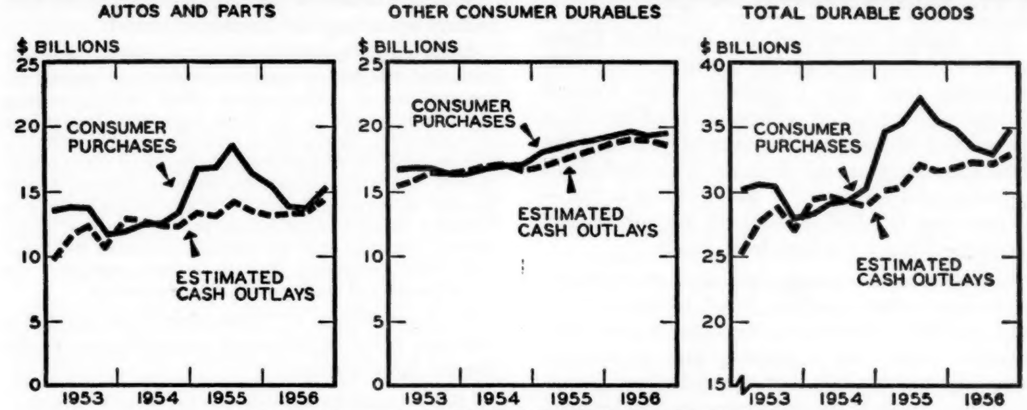
During January, several major companies reaffirmed earlier announcements of expansion programs. The American Iron and Steel Institute reported that the nation's steel companies, despite rejection of their applications for accelerated amortization, planned to spend $1.7 billion on modernization and expansion this year, compared with $1.2 billion in 1956.

Steel finishing facilities, in particular, are needed. The major bottleneck in both heavy construction and output of equipment continues to be the availability of the necessary types of steel products. For certain items, such as oil pipe, prospective demand is measured not in months but in years; supplies of structural steel shapes and heavy plates are as tight as ever despite record shipments.

Other types of steel, however, are getting back into better balance with demand, and in some items, notably cold-rolled sheet, steel users appear to have rebuilt their inventories. Warehouses report they now have "plentiful" supplies of 85 per cent of the industrial steel products they usually sell. Steel output in January has averaged close to 2.5 million tons a week. In addition, a sizable amount of steel has been made available to other users through the cutbacks and cautious inventory policies of automobile companies, whose spring production plans are still uncertain.

Outlook for Autos

Automobile production and sales are now somewhat higher than the reduced rate prevail-



Consumer Purchases and Estimated Cash Outlays for Durable Goods
(Seasonally adjusted annual rates)

Note: Cash outlays equal consumer expenditures minus new instalment credit extended and plus repayments of old instalment credit.

ing a year ago. To date, however, the sales of '57 models have been spotty and, in the aggregate, not up to earlier optimistic expectations. Consumers' incomes are high, their outlook generally optimistic, and their interest in the new styling evident, but there has been no surge of buying as in the early stages of the 1955 and 1956 model years. Price resistance has been suggested as one explanation. Less dealer emphasis on volume and more on profit margins may tend to increase effective prices to the consumer. Dealers, fortified by protective legislation and new contracts, no longer are under as much pressure from the factories to build up sales volume as they were a couple of years ago. Neither are inventories as oppressive as last year; new car stocks in January were down about 200,000, or approximately one fourth, from a year earlier.

Because the industry cut inventories substantially, 1956 was one of the few years in automobile history when domestic sales exceeded production. Last year, dealers sold nearly 5.9 million new cars and almost 200,000 were exported; production totaled only 5.8 million and the rest came out of stocks. In 1957, the situation is reversed. Even if dealer sales are no greater than in 1956, the need for exports will push production to about 6.1 million and any added sales or additions to year-end inventories will boost output still more.

Automobile industry spokesmen have not given up on their target of 6.5 million cars in 1957. Production in January was about on schedule, and the same rate of production — about 143,500 cars a week — is scheduled for February, according to Ward's Automotive Reports. The big question is whether there will be the usual upsurge in sales in the spring. Last year, car sales failed to increase seasonally and sharp production cutbacks resulted. This year, the industry is feeling its way more cautiously.

Meanwhile, the consumer holds the key to the situation. Through consumer credit, people have been able to purchase more durable goods than they could pay for out of the current year's income. The accompanying chart contrasts consumers' purchases of autos and other consumer durable goods with rough estimates of their cash outlays — that is, cash sales and down-payments on current purchases plus repayments of instalment debt on earlier purchases.

In the case of automobiles, the chart demonstrates the extent to which the sales increase in 1955 was accomplished through more liberal use of credit. Consumers' cash outlays were only moderately higher, the greater number of cars sold apparently being offset by lower down payments. Automobile sales plummeted in 1956, but consumers' out-of-pocket outlays were virtually unchanged from 1955. The cut in new purchases in 1956 was offset by mounting repayments on cars purchased earlier.

Despite the wide swings in the automobile market, cash outlays for durable goods as a whole have shown a fairly steady upward trend. Even more remarkable, this trend has been closely in line with the rise in disposable income. To some this might signify consumer self-discipline in not stepping up new purchases until payments on old ones had been brought down to manageable proportions; to others it might mean that sales increases based on excessively liberal credit terms tend to be temporary and may even depress the market for the next year or so.

A $72 Billion Federal Budget

The budget presented by President Eisenhower to Congress covering the fiscal year 1958, beginning next July 1, indicates that Federal Government spending will reach $71.8 billion, a rise of $2.9 billion over the current year and the third successive annual increase. This excludes a growing total – now up to $14.4 billion a year – of spending handled outside the regular budget accounts through various trust funds.

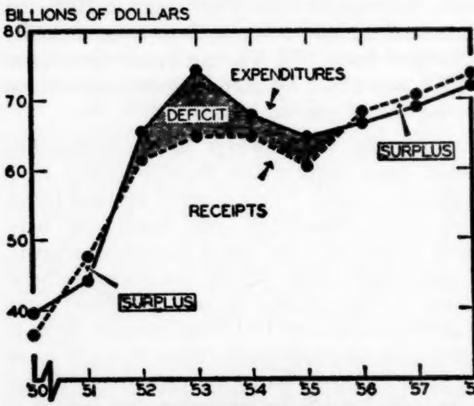
Government budget receipts also are estimated to increase next year, to $73.6 billion, a new high and $3.0 billion above the current year. This increase counts on a growing and prosperous economy, and assumes that rate reductions in corporation income taxes and excise taxes scheduled under existing law to take effect on April 1 will again be postponed by Act of Congress. Outside of some minor benefits to small business, the President has no tax concessions to suggest, on the general principle that increases in expenditures are more vital than tax reliefs.

Federal Budget Expenditures and Receipts

(In Billions of Dollars)

Years Ended June 30	Expenditures: National Security	Expenditures: "Civilian"	Expenditures: Total	Receipts Total	Deficit(—) or Surplus(+)
Actual					
1953	$50.3	$24.0	$74.3	$64.8	—9.5
1954	46.9	20.9	67.8	64.7	—3.1
1955	40.6	24.0	64.6	60.4	—4.2
1956	40.6	25.9	66.5	68.1	+1.6
Estimated					
1957	41.0	27.9	68.9	70.6	+1.7
1958	43.3	28.5	71.8	73.6	+1.8

The resultant budget surplus of receipts over expenditures amounting to $1.8 billion would, if achieved, represent the third year in a row that the federal budget has been balanced. This contrasts with the record of the years 1931 through 1955, when the budget showed surpluses in only 3 years against deficits in the other 22.



U.S. Government Net Receipts, Expenditures, and Surplus or Deficit by Fiscal Years. Figures for 1957 and 1958 Estimated.

In justification of the continuing rise in total federal spending the President stated:

> While taking present economic conditions into consideration, the budget must also reflect the general responsibilities of a Government which will be serving 172 million people in the fiscal year 1958. In the face of continuing threats to world peace, our collective security must be strengthened through alert international policies and a strong defense. Progress toward greater equality of opportunity for all of our people as well as toward a balanced development and conservation of our national resources must go forward. Emphasis must continue upon promoting, through private enterprise, the development and productivity of our economy.

Implementation of these objectives takes the common form of increased expenditures, as the second table shows:

U.S. Government Expenditures by Major Programs
Fiscal Year 1958
(In Millions of Dollars)

	1958 Estimated	Amount above or below 1957 Estimated	Amount above or below 1956 Actual
National Security	$43,335	+2,370	+2,694
Int'l. Affairs and Finance	2,444	+ 62	+ 598
Veterans' Benefits	5,027	+ 176	+ 271
Labor and Welfare	3,538	+ 506	+ 762
Agriculture	4,965	+ 264	+ 52
Natural Resources	1,538	+ 167	+ 434
Commerce and Housing	1,748	— 521	— 280
General Government	1,451	— 419	— 178
Interest	7,360	+ 100	+ 514
Reserve for contingencies	400	+ 200	+ 400
Total	$71,807	+2,907	+5,267

Military Spending Raised

National security spending, at $43.3 billion, makes up 60 per cent of all federal expenditures projected for fiscal '58 and accounts for $2.4 billion of the rise in planned outlays. This reflects the increasing complexity and costliness of new aircraft, missiles and other modern weapons. Expenditures for guided missiles alone are slated to rise $533 million or 35 per cent, going above $2 billion for the first time. Atomic energy outlays are raised $400 million to a new high of $2.3 billion. And all along the line the upward drift of wages and prices has raised costs for the national security program as for everyone.

Military outlays should not, simply because of the importance of defense, be exempt from critical review. As President Eisenhower said in his State of the Union message on January 10:

> . . . we must not delude ourselves that safety necessarily increases as expenditures for military research or forces in being go up. Indeed, beyond a wise and reasonable level, which is always changing and is always under study, money spent on arms may be money wasted on sterile metal or inflated costs, thereby weakening the very security and strength we seek.
>
> National security requires far more than military power. Economic and moral factors play indispensable roles. Any program that endangers our economy could defeat us. Any weakening of our national will and resolution, any diminution of the vigor and initiative of our individual citizens, would strike a blow at the heart of our defenses.

As though in reply to reports of Congressional criticisms that the Administration is being "niggardly about defense appropriations," President Eisenhower gave assurance in the budget message that:

> I have given careful consideration to the many complex factors which enter into the development of a well-balanced military structure. I am convinced that the defense programs and funds for their support as recommended in this budget provide a wise and reasonable degree of protection for the Nation.

Civilian Expenditures Continue Up

Not only military outlays are rising. Despite postponement of some unspecified spending programs, and an assumption that Congress will raise postal rates to reduce if not eliminate the postal deficit, nondefense or "civilian" spending is projected at a new high of $28.5 billion in fiscal '58. This is $7.6 billion or 36 per cent above the $20.9 billion level to which they had been cut in fiscal '54, the first full year of the Eisenhower Administration.

This rise, broadly, reflects growth of old programs set by law (e.g., old age assistance), bigger outlays on relatively uncontrollable items (e.g., interest on the public debt), as well as the projected launching of numerous new programs (e.g., aids to school building and chronically distressed areas).

Every major program is being marked up in fiscal '58. Spending cuts for Commerce and Housing and General Government shown in the table are more apparent than real. The indicated decline for Commerce and Housing will not be effective until Congress raises postal rates, an action it refused to take in 1955 and 1956. Otherwise, spending on Commerce and Housing would increase $63 million to $2.4 billion.

In the General Government category the indicated reduction represents a change in accounting procedure. Federal contributions to government employes' retirement funds, formerly carried under the General Government category, are now distributed among other headings.

Spending on International Affairs and Finance, mostly for foreign economic aid, is budgeted for a $62 million increase to $2.4 billion. Outlays for Agriculture are increased $264 million, to $5.0 billion. A sharp cut-back in CCC price support costs, reduced from $3.6 billion in fiscal '56 to $2.0 billion in '58, is more than offset by increased outlays under the new Soil Bank and other programs designed to bolster farm income while reducing agricultural commodity surpluses.

More "Welfare" Outlays

Apart from National Security, the largest spending increase shown is for Labor and Welfare, which rises $506 million to above $3.5 billion for the first time. The mushrooming growth of this category of federal spending is illustrated by the fact that as recently as 1949 it did not exceed $1.6 billion. Since that time, for example, federal expenditures for the promotion of education have increased sevenfold, from $65 million to $533 million. The latter figure, for fiscal '58, includes the initial year's cost of the President's $2 billion plus program of federal aids to the States for school construction. Congress, mindful among other things of the traditional American fear of centralized control over education, did not approve similar projects when proposed last year.

Expenditures for Veterans' Benefits are slated to rise $176 million to $5.0 billion, largely because of the rising number of veterans and their survivors who receive non-service-connected pensions. Interest payments on the $276 billion public debt are figured at $7.4 billion, due to the higher rates the Treasury must pay.

Natural Resources, the category which includes the traditional "pork barrel" of river and harbor developments, is figured to rise $167 million to $1.5 billion, a new high and 39 per cent above what was spent as recently as '56. The President noted that "in view of the present active competition for labor, materials, and equipment" federal construction projects should be postponed where possible. Senator Paul H. Douglas of Illinois would go even further in curtailing this type of expenditure. Appraising the $4 billion total of all federal public works programmed, he told a television audience January 20 that he would cut $2 billion.

In his budget message, the President listed many evidences of increased efficiency: a reduction by more than 10,000 in the nonmedical staff of the Veterans Administration over the past four years; improvements in organization in the Department of Defense which reduced inventory requirements for overseas supply; an 11 per cent increase in mail volume in the Post Office Department handled by only 3 per cent more workers; and better utilization or sale of large quantities of federal surplus property.

Doubtless, as the President states, there are many "meritorious" projects that had to be left out. Doubtless, too, there are many projects included that could have been put off. After all it is necessary in budget-making to look at "needs" in cold figures and see how they add up. This is as true in government reckoning the costs of dams and free benefit programs as it is in industry deciding on expansion plans and employe benefits or in the individual household

deciding on a new home or magazine subscription.

In the case at hand, expenditures add up to within a relatively close margin of income, optimistically projected.

The Menace of Inflating Expenditures

In his State of the Union message, the President identified inflation as "the principal threat to efficient functioning of a free enterprise system" in a prosperous period.

> We look back upon four years of prosperous activities during which prices, the cost of living, have been relatively stable — that is, inflation has been held in check.
>
> But it is clear that the danger is always present, particularly if the Government might become profligate in its expenditures or private groups might ignore all the possible results on our economy of unwise struggles for immediate gain.
>
> This danger requires a firm resolution that the Federal Government shall utilize only a prudent share of the nation's resources, that it shall live within its means, carefully measuring against need alternative proposals for expenditures.

In his annual Economic Report the greater emphasis is laid on self-discipline among the people:

> Even more exacting are the responsibilities of individuals and economic groups. Business managements should formulate and carry out their plans so as to contribute to steady economic growth. They must also recognize the broad public interest in the prices set on their products and services.
>
> Both management and labor should remove restrictions on the operation of competitive markets and enhance the economy's adaptability to change. Of particular importance in a prosperous economy is the responsibility of leaders of business and labor to reach agreements on wages and other labor benefits that are consistent with productivity prospects and with the maintenance of a stable dollar.
>
> Reliance for stability in economic growth cannot be placed exclusively on the fiscal and monetary policies of Government. The successful extension of prosperity with price stability calls for a cooperative effort in which the policies of individuals and economic groups and of all levels of government are consistent with one another and mutually reinforcing.

This is good, but inadequate in the circumstances. How much opportunity has the citizen to exercise restraint on the expenditure of his income when such a large percentage of it is taxed away to be spent by government? How much is there that the individual business man or wage-earner can effectively do, by his own forbearance in price or wage demands, toward maintaining economic stability when increased government spending is competing with his take-home pay and generating inflationary pressures throughout the economy?

It is cause for satisfaction that the budget is being held within the limits of prospective revenues for a third consecutive year, and that the surplus revenues are sufficient to avoid need for another temporary increase in the public debt limit this autumn. This is a remarkable change from the huge deficits being programmed and realized only a few short years ago. The facts that the budget was rebalanced after tax cuts in 1954, and that the price level was broadly stabilized, are even more noteworthy.

But now we have a fresh upsurge of government spending and — by no matter of accident — a fresh upsurge of inflationary pressures. The Federal Reserve System has been attempting to preserve economic balance by restricting the supply of credit and forcing home builders, industry, and municipalities to cut down their construction plans. It is a question whether credit policy can be applied strongly enough to counter the inflationary influence of rising federal expenditures. There is no suggestion in the budget that the Federal Government should observe the red flags of rising interest rates and rising prices by curtailing its spending and speeding debt retirement. Some government spending programs — for example, aids to home builders — are specifically designed to relieve effects of restrictive credit policies.

Surplus Too Little

There are two things wrong with the projected surpluses for fiscal '57 and '58: they are too tenuous and they are too small. The surpluses rest in part on postal rate increases Congress has been unwilling to impose. They are imperiled by the renewed tendency of actual expenditures to run beyond original estimates. Most important, they are calculated on the optimistic assumption that business will grow and prosper without stimulus from tax rate reduction. At some point, unless policy is changed, the economy is bound to founder on shortage of saving and discouragement to initiative, impairing not only the revenues but also the foundations of industrial strength.

The budget surplus, with the assumed raise in postal rates, is put at $1.8 billion for fiscal '58. This is no more than 2½ per cent of the projected revenues and less than one half per cent of the gross national product. On the cash budget basis, which counts in transactions through various trust funds, the fiscal '58 surplus is calculated at no more than $3 billion which is 3½ per cent of total cash receipts and seven tenths of 1 per cent of the national product.

On neither basis is the surplus rising along with the revenues, and building the groundwork for tax reductions necessary to finance economic progress.

Economic stabilization theory holds that flush revenues of prosperous times should be used to generate budget surpluses, draining off excess spending power for public debt retirement. This assumes that government spending will hold steady, if not decline because of reduced needs for aids to the unemployed, etc. But in this boom period government spending is not holding steady. It is rising with the revenue curve and creating a menace to economic stability.

A Budget Out of Hand

This is the picture of a budget out of hand. Mr. Walter Lippman commented in the *New York Herald Tribune* that "if this is the best that George Humphrey can do in a period of abounding prosperity, no one else is likely to do so much in any other time."

Treasury Secretary Humphrey, while accepting the budget as "apparently the best we can do" in the circumstances, did not mince words in discussing the perils in this trend. In a press conference, he urged that the trend toward higher spending "should be promptly stopped":

> I would certainly deplore the day that we thought we couldn't ever reduce expenditures of this terrific amount, the terrific tax take we are taking out of this country. If we don't over a long period of time, I will predict that you will have a depression that will curl your hair, because we are just taking too much money out of this economy that we need to make the jobs that you have to have as time goes on.

Representative Clarence Cannon, Chairman of the House Appropriations Committee, called the fiscal '58 budget "unconscionable" and the largest "ever presented in peacetime in any country in the history of the world." He charged that the United States is now in a state of price inflation "due to solely one thing and that is spending by the Congress under recommendation and urgent insistence of the Administration."

It is doubtful if the Administration should be called on to bear full responsibility for rising prices. Apart from the fact that one factor in inflation is the steady upward push of wage costs, many Congressmen have criticized the Administration for not spending more. Indeed, last summer the Air Force was voted an extra $900 million despite objection from the Secretary of Defense and the President that the money was not needed.

Asked whom he blamed for the increased spending and the increased number of federal government employes, Mr. Humphrey replied, "Everybody":

> Congress enacts laws that start with the public. The public, various groups of the public — and it is getting so more and more — keep turning to the Federal Government for everything in the world to be taken care of. Whenever anybody gets into a little bit of trouble he immediately runs to Washington and asks for something to be done about it.
>
> The pressure is put on Congress to enact laws to help them. Congress enacts some laws to help them and the Executive, when the laws go in, has to support the laws and work with the laws and that adds to the payrolls and it adds to the employment and it adds to the cost of Government and that adds to the taxes . . .

And — the Secretary might have gone on to say — the higher taxes erode the base for State and local taxation, as well as for individual self-reliance, leading to still more demands on the Federal Government for money. Somehow we need to stop this gravitation of all spending decisions to Washington.

What is there to do? Secretary Humphrey puts the answer in four points:

> First: We must seek the full cooperation of the public generally in limiting its demands upon the Federal Government for only essential Federal functions.
>
> Second: We must request the support of the Congress.
>
> Third: We must require every agency of the Government to take vigorous measures, without harm to either security or service to the public, to see that actual expenditures are kept well within the present budgeted figures . . .
>
> Fourth: We must plan for the 1959 budget, giving urgent attention to making further reductions both in Government employment and in expenditures where these savings will not lessen our security or the quality of the necessary services rendered to the public.

Asked to comment on the budget in his press conference of January 23, President Eisenhower asserted his complete agreement with Secretary Humphrey's statement, denied that he had made any basic change in his approach to Government, and pointed out that the "proportion of the gross national product we are now taking is not greater than it was, say, in '54." The following table shows percentages of actual and projected government expenditures to estimated gross national product since fiscal '53.

Government Expenditures and Gross National Product

(Dollar Figures in Billions)

Fiscal Year	GNP	—Expenditures— Federal Cash	State & Local	Proportion of —Expenditures to GNP— Federal	State & Local	Total
1953	$357.9	$76.8	$30.1	21.5%	8.4%	29.9%
1954	359.7	71.9	33.7	20.0	9.4	29.4
1955	372.8	70.5	37.2	18.9	10.0	28.9
1956	402.6	72.6	41.6	18.0	10.4	28.4
1957*	420.0	78.3	44.6‡	18.6	10.6	29.2
1958*	435.0†	83.0	47.6‡	19.1	10.9	30.0

* Estimated. † Estimated "normal" increase without price inflation. ‡ Estimated annual increase of $3 billion.

The thing that disturbs business people is the newly rising drift — from an already high level — in the proportion of the national product appropriated by Government. Extended indefinitely, such a drift corrodes the dollar, demands higher

and higher taxes, and crowds in on the opportunities for free enterprise and for people to spend their money as they please.

Referring to Mr. Humphrey's warning of depression ahead, President Eisenhower explained that the Secretary was not concerned about the immediate future but "about a long-term continuation of the spending of the order of which we are now doing." In what shape crisis one day will mature can never be predicted, though the historical record is that every spree of injudicious spending has a sequel of painful retrenchment. Meanwhile, the state of the nation's finances hangs as a shadow over an otherwise bright economic outlook.

Patman on the Public Debt

In an interview published in the January 11 issue of *U.S. News & World Report*, Congressman Wright Patman of Texas denies that we have any inflation and calls it a "ghost to just let the moneylenders profit." His attention called to the rising drift of prices during 1956, he uses this fact as a proof that higher interest rates do not stop inflation. If inflation is not a serious problem, difficulties in borrowing money to spend – of which higher interest rates are symptomatic – deserve some credit.

But, Congressman Patman sees little merit in a restrictive credit policy. "A rise in interest rates," he says, "has never brought out much more savings and has never prevented borrowing."

Yet, if credit conditions have no real economic effects how can it be, as he further observes, that "a recession inevitably follows a high interest policy"?

With equal truth, the Congressman could have said that rising prices inevitably follow a cheap money policy. And he might also have noted that moneylenders have more to lose out of deflation and depression than they stand to gain out of higher interest rates during a preceding boom. Everyone should want rates that are consistent with economic stability, whether higher or lower.

"The Best Time on Earth"

We can all share the concern Congressman Patman has to express over the rise in the cost of the federal debt. When this debt was being built up toward its present swollen dimensions some people argued that it didn't matter because "we owe it to ourselves." But it does matter to the taxpayer and also to the money market that is burdened with carrying all these securities and would like to get the money back to lend to industry, home builders, and school districts.

The national debt, as the Congressman says, "is almost in competition with the progress of the country. . . . *Now is the best time on earth to pay off some of the national debt.*"

To which one may say "Amen." Economy in government is the real way not only to save interest on the public debt, but also to relieve excessive taxation, ease the strain on the money market, and release resources for the citizen's productive use.

One thing every Congressman might well bear in mind is that a vote for higher appropriations is a vote for higher interest costs and higher taxes and less money for industry, home builders, and school districts.

The Great Drought

President Eisenhower's mid-January inspection tour of the nation's drought-ravaged midlands centered public attention on what threatens to be a major calamity.

The drought, which has persisted continuously since 1952, is potentially the worst this country has experienced. Severe dust storms can be expected unless sufficient rainfall is forthcoming in the next few months.

While droughts cannot be prevented, man has done much to aggravate their devastating effects. Millions of acres, because of cultivation, overgrazing, or both, no longer support good stands of native forage plants, and as a result are wide open to sweeping winds. More than 2½ million acres of crop and ranch land in the Great Plains States already have been damaged, with another 29 million acres "ready to blow" this winter and spring.

The seriousness of the problem is further indicated by the fact that, of the 1,100 counties in 15 western States, about 700 are now designated as drought disaster areas eligible for U.S. Government aid. The Agriculture Department during the past three years has spent some $550 million for disaster relief and an additional $184 million to bolster livestock prices.

Origin of the Problem

Improper land use – the root of the drought problem – goes back a long way. In part, it was due to patriotic response to pleas by the Government during World War I that farmers grow more of everything – especially wheat.

An even bigger spur to overplanting was the high prices. Farm prices of wheat, which in 1912 averaged 81 cents a bushel, skyrocketed to $2.16 a bushel by 1919. Harvested wheat acreage in six States currently hard-hit by the drought (Nebraska, Kansas, Texas, Oklahoma, Colorado,

and New Mexico) jumped from less than 12 million acres in 1912 to over 22 million by 1919. After the war most of the wheat land in these States remained in cultivation; in 1940 harvested acreage totaled about 19 million.

The advent of World War II, the maintenance of high, rigid price supports for several years thereafter, and adequate rainfall during that period all contributed to a further rise in wheat acreage. By 1952, the last year wheat was grown free of acreage restrictions and marketing quotas, acreage had soared to a peak of 31 million. One dust bowl county in eastern Colorado, which reported only 5,000 acres in wheat before World War II, had 365,000 acres in 1952.

Generally speaking, the bulk of land broken up and put into wheat in the Great Plains during the past 40 years was unsuited for that purpose and should have stayed in grass.

Immediate Relief and Long-term Remedies

Aside from its toll on the land, the drought has brought with it much personal tragedy. Many farmers and ranchers are in danger of losing their homes, land, livestock, and machinery. Their plight cannot be ignored – especially since the Government's price support and other policies encouraged farming in these areas.

President Eisenhower, after his tour of the drought territory, proposed government help in two ways: short-term relief and long-term remedies. For the short-run, he asked the Congress to earmark $76 million for immediate aid – emergency feed, conservation measures, and refinancing of farm debt by direct loans.

For the long-term, the President called for more research "to get the knowledge from which we are going to base . . . integrated programs" and pledged his support for the Great Plains program which he presented to the Congress a year ago. This authorized the Agriculture Department to enter into conservation contracts with farmers for as long as 10 years. Its aim is to get land into its best use; institute sound water, conservation and soil management practices; and combine farm units for efficiency.

These objectives, if achieved, will involve some farmers shifting to better farming areas or leaving agriculture entirely – often for full-time work on the part-time jobs now held. Up to now, in contrast to the 1930's, the current drought has caused relatively few farmers to migrate to other areas.

Large-scale Irrigation Projects

Large-scale water conservation and irrigation projects have been suggested as another long-term drought remedy. The President on his tour was confronted with many recommendations for such schemes. In Texas alone proposed projects would cost $1 billion.

Such proposals raise the question whether it is in the interests of the taxpayers, or the farmers themselves, to embark upon costly projects for expanding agricultural production at a time when there are already burdensome farm surpluses and the Government is spending billions of dollars annually to support farm prices.

Advocates of pushing ahead with irrigation projects not only cite the need to prevent land damage from dry cycles, but also contend that the present farm acreage will within a few years prove inadequate to supply the food and fiber requirements of our growing population. They point out that our total crop land base has not increased in a generation and in recent years has actually been declining. It is estimated that some 1,100,000 acres are being lost for crop use every year to urban and suburban development, industry, airports, military establishments and new highways; also that there is a productivity loss of another 700,000 acres a year through soil erosion, tree planting and waterlogging, contamination, and other causes.

Agricultural experts, however, are by no means in agreement that, taking into consideration the rapid advances in farm technology, additional acreage will be required to keep pace with population increases. The great strides being made in farm productivity have been strikingly demonstrated in recent years by the continued bumper crops and record livestock production in spite of government efforts to curtail output by restriction of acreage. Last year's crop output, despite the smallest harvested acreage in 20 years, equalled previous records.

Commenting on proposed irrigation projects in Canada, the preliminary report of the Royal Commission on Canada's Economic Prospects last December made the following statement:

> Settlement policies designed to bring more land under cultivation were essential in the early days; and other programmes with the purpose of inducing expansion of production may have been appropriate. Under the conditions of today and of the near future such policies and programmes would tend to have a depressing effect on farm prices and incomes. We suggest that substantial irrigation projects, while desirable from the standpoint of local areas, could be harmful rather than helpful to farmers in the aggregate. At some time in the future, extensive irrigation schemes, settlement plans, and programmes designed to expand production may be desirable; in the near term we believe that the funds which would be necessary for these purposes could be better used in other ways.

These forthright remarks appear equally applicable to the problem in the United States.

$2 An Hour

In this country, where the average person long has enjoyed the highest living standard anywhere, new evidence of improved economic well-being abounds. To the long list of records set in 1956 in such areas as over-all employment, income, and ownership of material goods, was added this significant milestone: factory workers' average earnings climbed to $2 an hour for the first time.

The $2 level, reached in September, has been exceeded in every month since. In December – latest month available – the rate was $2.05. Factory workers' wages crossed the $1 line in January 1944 so they have doubled in a little over 12 years, equivalent to an average annual wage boost of 5.6 per cent compounded.

The rapid advance to the $2 level is even more noteworthy when today's work week is compared with that of 1944. In that year, the average was five hours longer – 45 hours compared with 40 currently – and more hours were worked at overtime rates. Nor do wages and hours alone measure all of the workers' gains. According to the U.S. Chamber of Commerce, fringe benefits for factory workers – such as pensions, insurance, and vacations – cost employers 44.8 cents per payroll hour in 1955 against 18.4 cents in 1947.

The Chamber of Commerce in its bulletin *Economic Intelligence* for December declared: "We congratulate the American economy on achieving this [$2] landmark." The AFL-CIO in its November *Economic Trends and Outlook*, under the heading "$2 An Hour Is Not Enough," declared that this is not "the end of the road or even a spot to linger or rest." On which the Chamber commented: "We concur enthusiastically."

Not only did the Chamber and the AFL-CIO hail the attainment of the $2 earnings level, but both looked forward to the goal of $3 an hour – in the words of the AFL-CIO, "the next most convenient spot on the road ahead."

Real vs. Illusory Gains

These are brave words. No doubt everyone would like to believe the goal is as good as it sounds. But in all this talk of wage gains in the past and new objectives for the future, two basic considerations are involved.

First, what kind of dollars are we thinking of? Are they dollars of constant purchasing power, or dollars whose worth has been diluted by price increases?

Second, what has made the American worker the highest paid in the world?

As to the first point – earnings in terms of purchasing power – it would be unfair to the economists of the Chamber of Commerce and the AFL-CIO to imply that they are unmindful of the difference between money and "real" earnings (adjusted for changes in living costs). Both recognize that not all of the wage gains of the past 10-25 years have resulted in commensurate gains in living standards.

As shown by the following table, factory workers' hourly earnings have doubled since 1944 but the consumer price index has risen from 74.4 to 118.0, or by 59 per cent. In effect, the worker is only about 30 per cent better off in terms of actual buying power than before. The rest of the gain is an illusion.

Factory Workers' Money and "Real" Earnings

Date Achieved	Average Hourly Earnings	Consumer Price Index (1947—49=100)	"Real" Hourly Earnings
1920	50c	85.7	58c
Nov., 1933	50c	56.4	89c
Jan., 1944	$1.00	74.4	$1.34
Oct., 1950	$1.50	105.0	$1.43
Sep., 1956	$2.00	117.1	$1.71
Dec., 1956	$2.05	118.0	$1.74

Even so, the record represents substantial progress, and the figures become still more impressive when measured against those of the twenties.

Forces for Solid Growth

This brings up the second point – the forces making for solid advance.

There is no real doubt about where they lie: in the high and rising productivity of the American economy. The difficulties come not from unawareness of the facts but from how we behave in practice.

As the Chamber of Commerce expresses it: "These giant strides in real wages are ultimately a function of a skilled labor force and the accelerated pace of technological change, as put to practical use by billions of dollars of investment in new machines, processes and products, under competent business direction."

The AFL-CIO, on the other hand, while conceding that "the $2 mark has not been reached through any system of automatic progression," but "reflects the high productivity of the American economy – the skills of its workers and managers," nevertheless claims that "in large measure it has been the actions of American trade unions that have brought workers' earnings to this level." The statement continues:

> Wages have risen so consistently only because national unions and their locals have made the specific effort to improve wages, hours, and working conditions of American workers, frequently against strong employer opposition and hostile anti-labor legislation.

It is encouraging to note AFL-CIO acceptance of rising productivity as the basic source of labor gains, notwithstanding that featherbedding and other restrictive practices by some unions have often done violence to this principle. There is no denying that union pressures have spurred management to seek ways of offsetting higher wage costs by increased efficiency. The essential point, however, remains: the money to pay the higher wages would not have been there but for the huge investments in labor-saving and cost-cutting equipment.

As estimated by the National Industrial Conference Board last November, the capital invested per manufacturing production worker in early 1956 amounted to nearly $14,000, about double the '46 figure. In a similar study in October, the New York Stock Exchange calculated that for 19 out of 20 manufacturing industries the capital invested per full-time employe increased more than 50 per cent between 1947 and '55. In the same period wages paid in these industries scored sharp advances, with 12 of the 20 groups showing rises in average earnings per employe of more than 50 per cent.

Wage Inflation

There is ground for genuine satisfaction in these achievements of the American economy in making possible higher real wages and an improved standard of living. Given a continuation of the advance in general economic efficiency that helped to raise wages to $2 an hour, there is no reason why the $3 goal envisioned by the Chamber of Commerce and the AFL-CIO should not, in good time, be realized.

But this goal will be meaningful only if the inflationary forces are contained. In the view of many, the major inflationary threat today, both in our domestic economy and abroad, arises not from the fiscal and monetary policies of governments but from the upward wage pressures of powerful trade unions. This concern over "wage inflation," prompted by repeated rounds of wages and price increases, manifests itself in two forms.

First, such concern is rapidly becoming the foremost worry of business men for the months immediately ahead. With over-all business activity levelling off and competition growing, more and more enterprises are finding profit margins squeezed. They are wondering how far this will go and, how much it will affect expansion plans.

Such worries are hardly allayed by recent statements of some labor leaders as to the further wage and fringe benefit demands with which industry may expect to be confronted. Walter Reuther, president of the United Automobile Workers, announced in December he planned to "wallop" the auto industry next year for the "biggest wage increase" in his union's 21-year history. Early in January, David McDonald, president of United Steelworkers of America, said his union was considering going after "some form of shorter hours with no loss in pay." One of the "possibilities" he mentioned was an extra three-to-four-month paid vacation every five years for each union member.

Nor can reliance be placed upon the comfortable assumption suggested in the AFL-CIO quotation cited above that union wage pressures will spur management to more cost-saving expenditures, restoring profit margins and providing a sustaining flow of business to the capital goods industries. This might be true up to a point, but as explained in the President's Economic Report:

> In some cases, declining profits tend to accelerate capital outlays, as businesses seek to reduce costs through installation of more efficient productive facilities; in others, capital outlays are adversely affected, as lower profits reduce both the incentive and financial ability to maintain or augment these expenditures.

The second form of concern over wage inflation has to do with the longer-range problem of reconciling price stability with full employment. More and more, the conviction has been growing that, with governments everywhere committed to full employment, we are in an age of inflation in which a persistent upward trend of wages and prices and a decline in the purchasing power of money are inevitable. This is a dismal prospect for those who must live on fixed incomes or savings, as many know from bitter experience.

How the conflict between full employment and stable money will be resolved has become one of the major issues of our time. It involves questions not only of the value of our money, but also — because of the tendency of inflation to provoke government intervention and direct controls — of the kind of society in which we want to live.

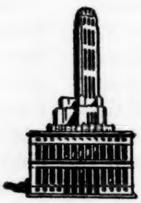
HIGHLIGHTS of 1956

from the Annual Report of

The First National City Bank of New York

and

City Bank Farmers Trust Company



In 1956:

▶Operating earnings, after taxes, totaled $51,-962,046 ($5.20 per share on 10,000,000 shares outstanding).

▶Operating earnings less losses on sales of securities totaled $46,890,586 ($4.69 per share).

▶Dividends paid totaled $26,000,000 equal to $2.60 per share. Quarterly dividend of 70 cents declared December 4 raised the annual rate to $2.80.

▶Total salaries, domestic and foreign, came to $64,453,000.

▶Taxes and assessments, here and abroad, totaled $52,842,000 before the credit for the transfer to the "Bad Debt" reserve.

▶Capital funds at the year-end total $602,182,963 ($60.22 per share) compared with $592,446,-606 ($59.24 per share) a year earlier.

▶Total resources of the Bank increased to $7,-427,000,000 and deposits to $6,672,000,000. Loans total $3,738,000,000. These are all-time highs. Unallocated reserves exceed $90,000,000.

▶Five new branch offices were opened; one in New York and four overseas.

▶The Bank has at the year-end 75 domestic offices and 70 overseas branches, offices and affiliates.

▶Depositors number 1,067,000, staff 16,137 and shareholders 63,893.

For copy of complete Annual Report, write the Public Relations Department, The First National City Bank of New York, 55 Wall Street, New York 15, New York.

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